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STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

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| **Del-Mar Water Company** | : | |
| | : | |
| | : | **Docket No. 02-0592** |
| **Proposed General Increase in Water Rates** | : | |

**ORDER**

**February 10, 2003**

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# STATE OF ILLINOIS
# ILLINOIS COMMERCE COMMISSION

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| | : | |
| Proposed general increase in water rates. | : | |

## ORDER

By the Commission:

## I. Procedural History

On August 19, 2002, Del-Mar Water Company ("Del-Mar" or "Company") filed its Ill. C. C. No. 10, 14th Revised Sheet No. 1, hereinafter referred to as its "Filed Rate Schedule Sheet." The Company therein proposed a general increase in water rates to be effective October 3, 2002.

On September 11, 2002, the Commission entered an Order suspending the Filed Rate Schedule Sheet to and including January 16, 2003. On January 8, 2003, the Commission resuspended the Filed Rate Schedule Sheet to and including July 16, 2003.

Notice of the proposed increase in water rates was posted and published in a newspaper of general circulation throughout the Company's service area in accordance with the requirements of Section 9-201 of the Public Utilities Act ("Act") and with the provisions of 83 Ill. Adm. Code 255. Notice of the filing was also sent to Del-Mar customers with the first billing after the filing.

Pursuant to notice as required by the law and the rules and regulations of the Commission, hearings were held in this matter before a duly authorized Administrative Law Judge of the Commission at its offices in Chicago, Illinois, on December 18, 2002. Appearances were entered on behalf of the Company, the Del-Mar Woods Improvement Association ("Association"), and the Commission Staff ("Staff"). The Company presented the testimony of Steve M. Lubertozzi, Director, Regulatory Accounting for Del-Mar's parent company, Utilities, Inc. ("UI"). The Association presented the testimony of its President, Michael J. Mascolino. Staff presented the testimony of Roy A. King of the Water Department, Financial Analysis Division. Staff also submitted by affidavit the testimony of the following witnesses: Burma C. Jones and Carolyn L. Bowers of the Accounting Department, Financial Analysis Division; and Rochelle Phipps of the Finance Department, Financial Analysis Division. At the conclusion of the hearing on December 18, 2002, the matter was marked "Heard and Taken."

At the conclusion of the hearing, the Company and Staff advised the Administrative Law Judge that they had resolved all matters in controversy. The Company and Staff therefore requested leave to waive the filing of briefs, and leave to file a Draft Order for the Administrative Law Judge's consideration. The Association did not object to these requests, which were granted by the Administrative Law Judge. The Company prepared a draft Administrative Law Judge's Proposed Order, to which Staff and the Association, after reviewing it, stated that they had no objection.

## II. Service areas and Nature of Operations

Del-Mar provides water service to approximately 83 customers in Lake County, Illinois. It is a wholly owned subsidiary of UI, which owns and operates approximately 81 water and/or wastewater systems in 17 different States. Water Service Corporation ("WSC") manages the operations for all of UI's water and sewer systems, including Del-Mar's water system. WSC provides management, administration, engineering, accounting, billing, data processing, and regulatory services for the utility systems. WSC's expenses are assigned directly to an operating utility or allocated to one or more of the various operating utilities pursuant to a formula that has been approved by this Commission. Del-Mar's current rate structure was approved pursuant to an order, dated October 21, 1998, in Docket No. 98-0046.

## III. Test Year

Del-Mar's filing is based on a historical test year ending December 31, 2001, with pro forma adjustments for known and measurable changes. Staff did not challenge the reasonableness of using a 2001 historical test year.

The Commission concludes that the test year ending December 31, 2001, with adjustments for known and measurable changes, is appropriate for the purposes of this proceeding.

## IV. Rate Base

In its testimony, the Company presented evidence showing that the value of its original cost rate base was $168,084 after making pro forma adjustments to its original cost rate base for the test year ending December 31, 2001.

Staff proposed various adjustments to the Company's pro forma rate base, including adjustments to plant in service and cash working capital. Staff's recommended rate base and related adjustments are included in Appendix A, Schedules 3 and 4 respectively, and can be summarized as follows:

(a) A net increase of $309,997 relating to the increase in the estimated amount of the Company financed portion of the total water main replacement costs less adjustments to the accounts for Wells and Springs and Hydrants. The Company has no wells or springs and all of its hydrants will be replaced, therefore those accounts should reflect zero balances.

(b) A decrease of $3,437 in the Cash Working Capital addition to rate base to account for changes in operating expenses.

(c) A decrease of $259 to Accumulated Depreciation to reflect an adjustment resulting from the retirement of Wells and Springs and Hydrants.

(d) An increase of $5,657 in the deductions from rate base to reflect an adjustment to Accumulated Deferred Income Taxes related to the increase in plant investment.

(e) An increase of $202,115 in the deductions from rate base to reflect the change in Contributions in Aid of Construction caused by the increase in the customers' estimated contributions towards the water main replacement.

(f) An increase of $2,198 in the deductions from rate base to reflect removal of the Investment Tax Credits related to retired plant.

The Company, for purposes of this proceeding, accepted all of Staff's recommended rate base adjustments as set forth in Appendix A, Schedules 3 and 4.

With respect to depreciation, the Company proposed the adoption of new depreciation rates for each plant account for Del-Mar, which would increase the current composite rate from 1.55% to 2.99%, as set forth in Mr. Lubertozzi's Direct Testimony. The depreciation rates were developed on the basis of an analysis of average service lives and net salvage values from other utilities' depreciation studies that Staff witness King had previously performed and that had been approved by the Commission.

Staff witness Jones proposed to modify the Company's new depreciation rates by plant account to recognize the effect on depreciation expense of that portion of new plant financed by the ratepayers through a Capital Investment Surcharge (discussed in Section VIII.) Del-Mar and Staff are in agreement on the test year level of depreciation expense generated by the modified rates, which yield a composite rate of 1.82%.

The Commission finds that the adjustments to rate base proposed in Staff's exhibits are supported by the evidence, are reasonable, and should be adopted. Upon giving effect to these adjustments, the Commission concludes that the Company's pro forma original cost rate base for the test year ended December 31, 2001 is $264,933. The Commission further finds that the proposed depreciation rates set forth in Staff Exhibit 5.00, Schedule 5.08 are reasonable and should be approved.

## V. Operating Revenues, Expenses, and Operating Income

In its direct testimony, the Company presented evidence of its pro forma operating revenues, expenses and income for the test year ended December 31, 2001, as follows:

| | |
|---|---|
| Pro Forma Operating Revenues | $ 22,636 |
| Pro Forma Operating Expenses | 25,585 |
| Utility Operating Income | $ (2,949) |

Staff proposed various adjustments to Del-Mar's pro forma operating statement. Staff's adjustments are identified below and attached as Appendix A, Schedule 2:

(a) A decrease of $535 in uncollectible accounts expense to reflect a 3-year weighted average of uncollectibles rather than actual uncollectibles in the test year.

(b) A decrease of $22,823 in maintenance expenses to remove main break repair expenses incurred in the test year and to prevent the double recovery of costs of purchased water (i.e., once through base rates and again through the separate Purchased Water Surcharge, which covers the cost of purchasing water from the City of Lake Forest).

(c) An increase of $3,696 to state and federal income taxes based on a unitary state income tax rate.

(d) A net increase of $11,127 to depreciation expense due to a change in depreciation rates, plant adjustments, and an increase in the cost of the water main replacement project.

(e) A decrease of $4,682 to pro forma rate case expense to account for actual expenses incurred plus a reasonable level of estimated legal costs.

The Company, for purposes of this proceeding, agreed with all of the above-described Staff adjustments.

The Commission finds that the adjustments to operating revenues, expenses (including taxes) and utility operating income as proposed in Staff's exhibits are supported by the evidence, are reasonable, and should be adopted. Upon giving effect to these adjustments, the Commission concludes that the Company's pro forma operating revenues, expenses and income, at the approved rates, for the test year ended December 31, 2001, are as follows and are attached in Appendix A, Schedule 1, hereto:

| | |
|---|---|
| Operating Revenues | $ 50,319 |
| Operating Expenses | 26,820 |
| Utility Operating Income | $ 23,499 |

## VI. **Capital Structure and Rate of Return**

### A. **Capital Structure**

Del-Mar proposed using UI's December 31, 2001, capital structure, comprising 46.91% debt and 53.09% equity. (Direct Testimony of Steven M. Lubertozzi at 4.) Staff witness Phipps testified that Del-Mar is a 100% equity financed, wholly owned subsidiary of UI. Thus, the financial risk of Del-Mar is essentially the financial risk of UI, and adopting UI's capital structure is appropriate. She proposed adopting UI's June 30, 2002, capital structure comprising 52.76% debt and 47.24% equity. (ICC Staff Exhibit 3.0 at 3.) Ms. Phipps recommended changing the capital structure measurement date to June 30, 2002, since that was the latest date for which debt and equity balances for UI were available and facilitated recognition of recent financing activity. (Id. at 4.)

Ms. Phipps' proposed June 30, 2002, debt balance includes only the portion of UI's $50,000,000, August 30, 2002 debt placement ("New Debt") that was used to refinance outstanding short-term debt. Ms. Phipps testified that since at least January 2000, UI has maintained an outstanding short-term debt balance at the end of every month indicating short-term debt has played a continual role in financing UI's assets. She testified further that excluding short-term debt and the New Debt would understate the proportion of the Company's capital that debt composes whereas including the New Debt in its entirety would overstate the amount of capital UI employed on June 30, 2002. (ICC Staff Exhibit 3.0 at 5.) Thus, Ms. Phipps recommended that the Company's June 30, 2002, capital structure reflect only the portion of the New Debt that replaced outstanding short-term debt. (Id.)

Ms. Phipps adjusted the Company's equity balance to reflect the June 30, 2002, common equity balance (i.e., $88,343,173). (Id. at 6.)

The Company agreed with Staff's proposed June 30, 2002, capital structure.

### B. **Embedded Cost of Debt**

Del-Mar proposed using UI's December 31, 2001, embedded cost of debt, 8.60%. (Direct Testimony of Steven M. Lubertozzi at 5.) Ms. Phipps testified that as of June 30, 2002, UI's embedded cost of long-term debt was 7.84%. (ICC Staff Exhibit 3.0 at 6.) The Company agreed with Staff's proposed cost of debt.

### C. **Cost of Common Equity**

Del-Mar proposed adopting a 10.9% return on common equity, which was Staff's recommended cost of common equity in Docket No. 01-0663. (Direct Testimony of Steven M. Lubertozzi at 6.)

Staff witness Phipps measured the investor-required rate of return on common equity for Del-Mar with the discounted cash flow ("DCF") and risk premium models. Ms. Phipps asserted that DCF and risk premium models cannot be directly applied to Del-Mar since its common stock is not market- traded. Therefore, she applied both models to a sample of public utilities ("Utility Sample") and a sample of water companies ("Water Sample") comparable in risk to Del-Mar. (ICC Staff Exhibit 3.0 at 7.) Ms. Phipps testified that a firm's market-required return on equity is a function of its operating and financial risks. Standard & Poor's ("S&P") business profile scores reflect the operating risk of a utility. She imputed a business profile score of 3 for Del-Mar that is based on the average business profile score of the thirteen market-traded water utilities listed on S&P *Utilities & Perspectives*. (Id. at 7-8.) To measure Del-Mar's financial risk, Ms. Phipps selected the four financial ratios for which S&P has established benchmark values: (1) funds flow from operations to total debt; (2) funds flow from operations to total debt; (3) pretax interest coverage; and (4) total debt to total capital ("Benchmark Ratios"). Since those ratios measure financial risk and Del-Mar's financial risk is that of UI, Ms. Phipps calculated the Benchmark ratios for Del-Mar using UI data from the period 1998-2000. A comparison of UI's financial ratios to the corresponding benchmarks for S&P business position 3 utilities indicates that the Benchmark Ratios for UI are consistent with an "A" credit rating. (Id. at 8.) To form the Utility Sample, Ms. Phipps selected all electric and gas distribution utilities listed in S&P *Utility Compustat II* database that matched Del-Mar's implied credit rating and business profile score. She further eliminated companies that (1) lacked either Zacks Investment Research ("Zacks") or Institutional Brokers Estimate System ("IBES") growth rates; and (2) were in the process of being acquired by another company. To form the Water Sample, Ms. Phipps included all water companies for which sufficient data to conduct DCF and risk premium analyses was available and that are not being acquired by another company. (Id. at 9.)

Ms. Phipps testified that according to DCF theory, the market value of common stock equals the present value of the expected stream of future dividends. The companies in her Utility Sample and Water Sample pay dividends quarterly. Thus, Ms. Phipps applied a constant growth quarterly DCF model. (ICC Staff Exhibit 3.0 at 10.)

Ms. Phipps asserted that the DCF methodology requires a growth rate that reflects investor' expectations. She measured the market consensus expected growth rates with projections published by IBES and Zacks. The growth rate estimates were combined with stock prices and dividend information as of October 15, 2002. Based on this growth, stock price and dividend data, Ms. Phipps' DCF analysis estimated an 11.16% return on common equity for the Utility Sample and 9.10% for the Water Sample. (ICC Staff Exhibit 3.0 at 11-14.)

Ms. Phipps testified that the risk premium model is based on the theory that the market-required rate of return for a given security equals the risk-free rate of return plus a risk premium associated with the security. She stated that the risk premium methodology is consistent with the theory that investors are risk-averse, requiring higher returns to accept greater exposure to risk. Ms. Phipps used a one-factor risk premium model, the CAPM, to estimate the cost of common equity. She asserted that in the CAPM, the risk factor is market risk, which cannot be eliminated through diversification. (ICC Staff Exhibit 3.0 at 14-15.)

According to Staff, to implement the CAPM, one must estimate the risk-free rate of return, the expected rate of return on the market portfolio and beta. (ICC Staff Exhibit 3.0 at 15.) Ms. Phipps used the current 5.24% yield for thirty-year U.S. Treasury bond as the estimate of the risk-free rate of return. (Id. at 18-19.) She estimated a 14.49% expected rate of return on the market by conducting a DCF analysis on the firms composing the S&P 500 Index. (Id. at 20-21.) Ms. Phipps computed an adjusted beta of

0.55 for the Utility Sample and 0.46 for the Water Sample, estimated over the sixty months ending August 2002. (Id. at 23.) Using these three parameters to implement the CAPM produced a 10.33% estimate of the required rate of return on common equity for the Utility Sample and 9.49% for the Water Sample. (Id.)

Ms. Phipps testified that a liquidity premium should not be added to Del-Mar's cost of equity. She stated that a liquidity premium arises from the costs associated with selling an asset at the desired time at a predictable price. Del-Mar is a wholly owned subsidiary of UI, which is a wholly owned subsidiary of NV Nuon. Accordingly, Del-Mar obtains equity capital from UI, which obtains equity capital from NV Nuon, a company that serves approximately one-third of the electric and gas distribution markets in the Netherlands and whose book capitalization totaled approximately $4.1 billion on December 31, 2001. NV Nuon's size, as indicated by its book capitalization, suggests that neither NV Nuon nor its subsidiaries to which it provides equity capital warrant a liquidity premium. (ICC Staff Exhibit 3.0 at 23-24.) Additionally, UI's August 2002 debt placement has a 5.41% interest rate and a ten-year term to maturity. The August 29, 2002, interest rate for financial bonds with ten-year terms to maturity equals 5.70%. According to Staff, UI's credit quality exceeds that for an A-rated company since the interest rate for ten-year, A-rated financial bonds exceeds the interest rate for UI's latest debt placement. Ms. Phipps testified that this information confirms that a liquidity premium for Del-Mar/UI/NV Nuon is unnecessary. (Id. at 24.)

Based on the DCF and risk premium models, Ms. Phipps estimated the investor-required rate of return on equity for Del-Mar equals 10.02%, which is based on the average of the DCF and risk premium-derived cost of common equity estimates for the Utility Sample and the average of the DCF and risk premium-derived cost of common equity estimates for the Water Sample. (ICC Staff Exhibit 3.0 at 24-25.) Ms. Phipps compared the Del-Mar's four three-year average Benchmark Ratios to those same three-year average ratios for both the Utility and Water Samples. She asserted that Del-Mar's ratios and those of the two samples were not materially different. Therefore, Ms. Phipps concluded that both samples were equally comparable to UI. (Id. at 25-26.) Furthermore, Ms. Phipps asserted that the cost of equity estimates for the Water Sample are relatively low. Similarly, compared to recent Staff analyses, the cost of equity estimates for the Utility Sample are relatively high. Therefore, Ms. Phipps concluded that an average of the cost of equity estimates for the two samples would be more appropriate. (Id. at 26.)

### D. Conclusion

The Company, for purposes of this proceeding, accepted Staff's recommended rate of return on common equity for the purpose of setting rates.

Based on the evidence presented, the Commission concludes the Company's cost of common equity is 10.02% and its overall cost of capital is 8.87% as proposed in Staff Exhibit 3.00, Schedule 3.10.

As of June 30, 2002, Del-Mar's overall cost of capital is summarized as follows:

| Component | Balance | Ratio | Weighted Cost | Cost |
|---|---|---|---|---|
| Debt | $ 98,648,827 | 52.76 | 7.84% | 4.14% |
| Common Equity | 88,343,173 | 47.24 | 10.02% | 4.73% |
| Total | $186,992,000 | 100.00% | | 8.87% |

VII. **Cost of Service and Rate Design**

The present and proposed rates per month and percentage of increase are as follows:

| Customer Charge | Present | Company Proposed | Increase | Staff Proposed | Increase |
|---|---|---|---|---|---|
| 5/8" | $ 8.84 | $ 25.00 | 183.0% | $ 12.30 | 39.1% |
| ¾" | $ 8.84 | $ 25.00 | 183.0% | $ 13.26 | 50.0% |
| 1" | $ 8.84 | $ 25.00 | 183.0% | $ 17.25 | 95.1% |
| 1.5" | $ 8.84 | $ 25.00 | 183.0% | $ 22.20 | 151.1% |
| Usage Charge (per 1,000 gals) | $ 2.05 | $ 4.56 | 122.4% | $ 5.62 | 174.1% |

The Staff proposed rates are detailed in ICC Staff Exhibit 7.00, Schedule 7.05. Note that the percent increases for the customer charges for the ¾" and 1.5" meters are irrelevant because no customers currently have meters of that size.

The Company accepted Staff's proposed rates. Under Staff's proposed rates, customers will experience an increase in their monthly bill (excluding the Capital Investment Surcharge) ranging from $10.89 to $17.92, an increase of $7.03 or 64.55%, for customers using 1,000 gallons, to an increase of $29.34 to $68.50, an increase of $39.16 or 133.47%, for customers using 10,000 gallons.

Staff witness King recommended in his Direct Testimony and Rebuttal Testimony that a construction fee described in the Company's current Rules, Regulations, and Conditions of Service be included in its rate tariff sheet as shown in ICC Staff Exhibit 7.00, Schedule 7.05.

Staff witness King also recommended that upon completion of the water main replacement project ("the Project") and prior to the Company filing the proposed rates, Staff conduct an audit of the construction invoices received in connection with the Project. If the actual construction cost differs by 5% or more from the estimate in this proceeding ($740,000), Staff should adjust rate base, and then recalculate rates accordingly, using the Cost of Service study presented in this docket.

In his Rebuttal Testimony, which responded to both the Rebuttal Testimony submitted by the Company and testimony submitted by Mr. Mascolino, Staff witness King recommended that the Company obtain a minimum of three bids before choosing the contractor that will perform the work, but did not state that the estimated cost was unreasonable. Also, Mr. King agreed with the Company that the water mains should be 8" in diameter to comply with Commission's rules, stated that the 35/65 split in the cost was reasonable and kept the "feeder" main as a component of his cost of service study. The Company agreed with Mr. King's recommendations.

The Commission finds the rate design principles and cost-of-service methodologies proposed in Staff's testimony, and the development and design of the rates in the manner proposed by Staff, are reasonable and should be adopted. The Commission concludes that the appropriate rates for Del-Mar are set forth in Section VII (Cost of Service and Rate Design) of this Order, adjusted as necessary if the actual cost of the Project differs by 5% or more from the estimate in this proceeding. To facilitate that determination, within six months of the Order date the Company should file a letter with the Chief Clerk of the Commission and a copy to the Manager of the Water Department reporting the progress of the water main replacement project, the costs incurred to date, and the anticipated completion date. Copies of invoices supporting payments made should accompany the letter that is sent to the Manager of the Water Department. If the project is not complete within six months of the Order date, the Company should file a letter each month thereafter until the project construction is completed and all costs of the project have been accumulated. When all costs have been accumulated, Commission Staff will conduct a review of the construction invoices received in connection with the water main replacement project and Staff will adjust rates if necessary pursuant to, and in the manner described in, Section VII hereto.

Upon completion of the Project and within ten (10) days after Staff audits the construction invoices and provides written notification of its findings to the Company and to the Chief Clerk of the Commission, the Company is directed to file the rates set forth in Section VII. The filed tariffs should have an effective date of not less than ten (10) business days after the date of filing with the office of the Clerk of the Commission, for service rendered on and after their effective date, with individual tariff sheets to be corrected within that time period if necessary.

## VIII. Capital Investment Surcharge

Per the request of Del-Mar's customers, the Company has undertaken to replace the water mains that serve Del-Mar's service territory, including the "feeder" main that connects the Del-Mar distribution system with that of the City of Lake Forest, from which Del-Mar obtains its water. By agreement, the Company will contribute approximately 35% of the cost of the project, which is estimated at $740,000 in this proceeding, and the customers will contribute the remaining 65%. The amount of $259,000 contributed by Del-Mar will be included in rate base, and will be recovered through the water rate increase described in Section VII. During the evidentiary hearing, the Association presented a list of one hundred plus signatures showing support for the new system.

The Company proposes that the customers pay their share of the costs, which calculates to $481,000, through a Capital Investment Surcharge that will be billed on a monthly basis over the next seven years, at a Staff-recommended interest rate of 8.87%. The amount will be divided pro-rata among Del-Mar's 83 customers, such that each customer will pay an equal sum. Staff agreed with the Company's proposal, but recommended that the Company provide an option to customers to pay their share as a single lump sum at the outset, in order to permit customers to avoid approximately $2,000 in interest charges. As recommended by Staff, the amount of the Capital Investment Surcharge will be $92.86 per month for seven years, or $5,795 if paid in a lump sum. The Company agreed with that recommendation and the Association did not refute the surcharge. Staff also recommended that the Company file the Capital Investment Surcharge at the beginning of the second month of construction, to become effective on the next billing cycle.

The Commission concludes that the Capital Investment Surcharge proposed by Staff is appropriate and directs the Company to file the Capital Investment Surcharge tariff sheet at the beginning of the second month of construction to become effective on the next billing cycle.

## IX. Rules, Regulations and Conditions of Service

Staff and the Company have been working together to update the current Rules, Regulations and Conditions of Service tariffs ("Service tariffs") for Del-Mar, which were dated between 1969 and 1985. In ICC Exhibit 4.0, Schedule 4.06, Staff witness King proposed new Service tariffs, with which the Company indicated it was in agreement. The new Service tariffs were compiled previously by Staff, provided to other Illinois regulated utilities, and approved by the Commission, most recently in Docket 01-0050 for Westlake Utility, Inc.

The Commission finds that the Rules, Regulations and Conditions of Service tariffs proposed by Staff in ICC Exhibit 4.00, Schedule 4.06 are appropriate and directs the Company to file these tariffs within thirty (30) days of the Order, with an effective date of not less than thirty (30) working days after the date of filing, for service rendered on and after their effective date, with individual tariff sheets to be corrected within that time period if necessary.

## X. Findings and Ordering Paragraphs

The Commission, having given due consideration to the entire record herein and being fully advised in the premises, is of the opinion and finds that:

(1) Del-Mar Water Company provides water service within the State of Illinois and, as such, is a public utility within the meaning of the Public Utilities Act;

(2) the Commission has jurisdiction over the Company and the subject matter herein;

(3) the recital of facts and conclusions reached in the prefatory portion of this Order are supported by the evidence and are hereby adopted as findings of fact;

(4) a test year ending December 31, 2001 should be adopted for the purpose of this rate proceeding;

(5) for the test year ending December 31, 2001 and for the purposes of this proceeding, the Company's rate base is $264,933;

(6) the agreement between the Company and its customers to replace the water mains is reasonable, as is the agreement to allocate 35% of the costs of such replacement to the Company (to be recovered through addition of those costs to rate base) and 65% of those costs directly to the customers in the form of a Capital Investment Surchage;

(7) The Capital Investment Surcharge of $92.86 per month for seven years or a lump sum of $5,795 is reasonable and should be the charge for that expense;

(8) a fair and reasonable rate of return on the Company's rate base is 8.87%; this rate of return reflects a fair and reasonable return on common equity of 10.02%; rates should be set to allow the Company an opportunity to earn that rate of return on its rate base, as determined herein;

(9) Staff's embedded cost of service study methodology is reasonable and the recommendations with respect to the rate design proposed by Staff should be allowed;

(10) the Company's rates which are presently in effect are insufficient to generate the operating income necessary to permit the Company to earn a fair and reasonable rate of return and those rates should be permanently canceled and annulled as of the effective date of the new tariff allowed in this Order;

(11) the rates proposed by the Company in this proceeding would produce rates in excess of that which is fair and reasonable; the Company's proposed rates should be rejected and the design of the rates in the manner proposed by Staff is reasonable and should be adopted;

(12) the Company should be permitted to file new tariff sheets setting forth the rates designed to produce annual operating revenues of $50,319; and revenues will provide the Company an opportunity to produce sufficient utility operating income to provide a return on the Company's rate base of 8.87% consistent with the findings herein;

(13) Commission Staff will conduct an audit of the construction invoices received in connection with the water main replacement project and Staff will adjust rates if necessary pursuant to, and in the manner described in, Section VII hereto;

(14) the Staff proposed rates contained in Section VII hereto are designed in accordance with the embedded cost of service and rate design determinations made in the prefatory portion of this Order herein above; the Company should be authorized to file new tariffs setting forth the rates and charges contained in Section VII, effective for all service rendered on and after ten (10) business days after filing.

IT IS THEREFORE ORDERED that the tariff sheet proposing a general increase in water rates filed by Del-Mar Water Company be, and the same is hereby, permanently canceled and annulled.

IT IS FURTHER ORDERED that Ill. C.C. No. 10 be canceled in its entirety. The cancellation date will be the same as the effective date of the new rate tariff and the Rules, Regulations and Conditions of Service tariffs.

IT IS FURTHER ORDERED that the Company file the bids and a copy of the specifications for the project as late filed exhibits.

IT IS FURTHER ORDERED that the Company file its Rules, Regulations and Conditions of Service tariffs, as included in ICC Staff Exhibit 4.0, Schedule 4.06, within thirty (30) days of the Order with an effective date of not less that thirty (30) working days after the date of the filing, for service rendered on and after their effective date, with individual tariff sheets to be corrected within that time period if necessary.

IT IS FURTHER ORDERED that the Company file the Capital Investment Surcharge tariff, in accordance with Finding 7 and Section VIII herein, at the beginning of the second month of construction to become effective on the next billing cycle, but not less than ten (10) business days after the date of filing.

IT IS FURTHER ORDERED that within six months of the Order date, the Company should file a letter with the Chief Clerk of the Commission and a copy to the Manager of the Water Department reporting the progress of the water main replacement project, the costs incurred to date, and the anticipated completion date. Copies of invoices supporting payments made should accompany the letter that is sent to the Manager of the Water Department. If the project is not complete within six months of the Order date, the Company should file a letter by the 7$^{th}$ day of each month thereafter until the project construction is completed and all costs of the project have been accumulated. When all costs have been accumulated, Commission Staff will conduct a review of the construction invoices received in connection with the water main replacement project and Staff will adjust rates if necessary pursuant to, and in the manner described in, Section VII hereto.

IT IS FURTHER ORDERED that the Company file new rate tariffs within ten (10) business days after Staff has provided written notification to the Company and to the Office of the Chief Clerk of the results of its audit of the cost of the completed water main project, with an effective date of not less than ten (10) business days after the date of filing for service rendered on and after the effective date, with individual tariff sheets to be corrected within that time period if necessary. The rates will be in accordance with Findings 12, 13 and 14 and Section VII herein.

IT IS FURTHER ORDERED that the Company provide evidence within sixty (60) days of the completion of the water main project that it has properly recorded revised depreciation rates and plant adjustments on its books and records. One copy of the evidence should be sent to the Chief Clerk of the Commission and one copy should be sent to the Commission's Manager of the Accounting Department.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.800, this Order is final and is not subject to the Administrative Review Law.

By Order of the Commission this __ day of _________, 2003.

(SIGNED) KEVIN K. WRIGHT

Chairman

(SEAL)

# Del-Mar Water Company
## Statement of Operating Income with Adjustments
### For the Test Year Ending December 31, 2001

| Line No. | Description | Company Pro Forma Present (Co. Sch. B) | Adjustments (Sch. 1.02) | Pro Forma Present (Cols. B+C) | Company Proposed Increase (Co. Sch. B) | Gross Revenue Conversion Factor | Proposed Rates With Adjustments (Cols. D+E+F) | Adjustment To Proposed Increase | Pro Forma Proposed (Cols. G+H) |
|---|---|---|---|---|---|---|---|---|---|
| | (A) | (B) | (C) | (D) | (E) | (F) | (G) | (H) | (I) |
| 1 | Water Service Revenues | $ 21,650 | $ - | $ 21,650 | $ 32,325 | $ (1,919) | $ 52,056 | $ (3,172) | $ 48,884 |
| 2 | Miscellaneous Revenues | 986 | - | 986 | - | - | 986 | 449 | 1,435 |
| 3 | Total Operating Revenues | 22,636 | - | 22,636 | 32,325 | (1,919) | 53,042 | (2,723) | 50,319 |
| 4 | Uncollectible Accounts | 802 | (535) | 267 | 1,197 | $ (838) | 626 | (32) | 594 |
| 5 | Maintenance Expenses | 27,976 | (22,823) | 5,153 | - | - | 5,153 | - | 5,153 |
| 6 | General Expenses | 11,159 | (4,682) | 6,477 | - | - | 6,477 | - | 6,477 |
| 7 | Depreciation | 4,719 | 9,085 | 13,804 | - | - | 13,804 | - | 13,804 |
| 8 | Amortization of CIAC | (8,764) | 2,042 | (6,722) | - | - | (6,722) | - | (6,722) |
| 9 | Taxes Other Than Income | 694 | - | 694 | 93 | (93) | 694 | - | 694 |
| 10 | | - | - | - | - | - | - | - | - |
| 11 | | - | - | - | - | - | - | - | - |
| 12 | | - | - | - | - | - | - | - | - |
| 13 | | - | - | - | - | - | - | - | - |
| 14 | | - | - | - | - | - | - | - | - |
| 15 | Total Operating Expense | | | | | | | | |
| 16 | Before Income Taxes | 36,586 | (16,913) | 19,673 | 1,290 | (931) | 20,032 | (32) | 20,000 |
| 17 | State Income Tax | (1,475) | 1,325 | (150) | 1,552 | $ (988) | 414 | (50) | 364 |
| 18 | Federal Income Tax | (9,526) | 6,856 | (2,670) | 10,024 | $ - | 7,354 | (898) | 6,456 |
| 19 | Deferred Taxes and ITCs Net | - | - | - | - | - | - | - | - |
| 20 | Total Operating Expenses | 25,585 | (8,732) | 16,853 | 12,866 | (1,919) | 27,800 | (980) | 26,820 |
| 21 | NET OPERATING INCOME | $ (2,949) | $ 8,732 | $ 5,783 | $ 19,459 | $ - | $ 25,242 | $ (1,743) | $ 23,499 |
| 22 | Staff Rate Base (ICC Staff Exhibit 5.00, Schedule 5.03, Column (D)) | | | | | | | | $ 264,933 |
| 23 | Staff Overall Rate of Return (ICC Staff Exhibit 3.00, Schedule 3.10) | | | | | | | | 8.87% |
| 24 | Revenue Change (Col. (I) Line 3 minus Col. (D), Line 3) | | | | | | | | $ 27,683 |
| 25 | Percentage Revenue Change (Col. (I), Line 24 divided by Col. (D), Line 3) | | | | | | | | 122.30% |